

INSIDE

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and Rita.

Richard A. Hughes, Vice President
Procter & Gamble's Global Purchases Organization

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By John Yuva

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HAT REPRESENTS A COMPANY'S MOST VALUABLE corporate assets? In many instances, physical assets, such as people, products or facilities, are the first to be identified. Executives can easily track and account for the movement and condition of physical assets and thus assign them the greatest amount of weight. While physical entities certainly comprised the majority of corporate assets 25 years ago, the dawn of the computer age ushered in new technology and a greater dependence on information. As such, the viability of today's companies rests with their intangible assets – most notably trade secrets.

In his article for the *National Law Journal*, "Duty to Identify, Protect Trade Secrets Has Arisen," R. Mark Halligan, a principal in the intellectual property law firm of Welsh & Katz, Ltd. in Chicago, says that trade secrets are estimated to comprise 80 per-cent of the assets in New Economy companies. "Unfortunately, many Fortune 1,000 companies do not have adequate systems in place for the identification and classification of their trade secret assets," he says. Because of supply managers' involvement with third parties, having an intellectual property (IP) focus in those relationships is essential in protecting trade secrets and other IP rights.

Trade Secrets Exposed

What constitutes a trade secret? As one of four intellectual property rights (trade secrets, copyrights, trademarks and patents), trade secrets are defined as information that is not generally known in the trade that (1) reasonable efforts have been made to protect and (2) that gives holder a competitive advantage.

Keep Your Chief

Are your company's employees a key assets? Not knowing w may cost companies millions of d

At a Glance

The main points covered in this article are:

- What constitutes a trade secret
- How trade secrets are protected
- The importance of trade secrets in the New Economy
- The role of supply managers in protecting trade secrets
- The consequences of trade secret theft

This can include everything from supplier and customer lists to product diagrams and specifications and even new product ideas written down on a napkin during a business lunch.

Halligan says one of the advantages of trade secrets is that they protect combinations of information. Thus, while each element may be known in the public domain, the unique combination of the information and the ability to derive economic value from it gives the holder the right to claim trade secret status. For example, a customer database includes the name, address and phone number of every customer. Each customer's information could be found in a phone book; however, the compilation of that data is not readily available and not generally known in the trade. It is therefore considered a trade secret.

Also protected are research and development trials. James Pooley, an intellectual property lawyer in Palo Alto, California, says that information about what doesn't work or works less well is also considered a trade secret. "Thomas Edison famously tried 399 different compounds for the light bulb filament before he found the compound of tungsten that worked," says Pooley. "If you were a competitor in the race with Edison to produce a commercial light bulb, wouldn't it be useful to know about the 399 attempts?" Because of the investment of time and money in R&D initiatives, the results remain an important company asset.

And how long are these valuable assets protected? Protection of trade secrets lasts only as long as the information is kept secret and is not disclosed to the general trade. Once the information is disclosed, the value of the trade secret is lost – which could mean losses in the millions or even billions of dollars. ➤

Asset

aware of your
who knows what
dollars per year.

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Consider the Coca-Cola Company and the mystique surrounding the company's secret formula. If the formula was revealed, the company risks losing its brand identity. In essence, trade secrets are what define a company and separate it from the competition.

Trade Secret Management in a Global Environment

Globalization is essential to remain competitive in the global marketplace, but it may come at the expense of trade

Factors Behind the Theft and Disclosure of Trade Secret Assets

According to the Trade Secret Office, Inc., in Naperville, Illinois, it is estimated that \$40 billion in trade secret intellectual property is stolen from U.S. companies every year. Fortunately, the majority of disclosures and thefts occur inadvertently. This means that with the proper training programs in place that educate employees about trade secret assets and protection, companies can greatly reduce the

accept it with that status and (3) the party agrees to receive the information in confidence means that the trade secret will instantaneously lose its status and value.

While the majority of trade secret losses are inadvertent, cases of intentional theft and disclosure do occur. It could be a disgruntled employee or an unlawful trading partner looking to damage the company and make some quick money. Either way, the information is protected under the Uniform Trade Secrets Act



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secret protection. Pooley explains that as companies expand and as supply chains become more integrated, it often means sharing information with more people who are spread across the world as well as placing greater trust in collaborative partnerships. As a result, maintaining the secrecy of information within an organization will be challenging because more people may be privy to it and the legal systems abroad may not be as robust in protecting intellectual property.

This should be a consideration when outsourcing such functions as R&D to foreign regions. Pooley says not only do executives have to be concerned about the ability and honesty of managers and employees abroad to protect the information that is developed there, but also whether the court systems in those regions will uphold the rights of the U.S. intellectual property holder. "As world business grows, the amount of trade secret information that is put at risk also grows and the challenges become more complicated," he says. Understanding why and how trade secret violations occur can go a long way in their prevention.

level and frequency of trade secret violations. Pooley says one of the most common violations occurs when employees leave the company and walk out with files and disks, not understanding what is available to use and what is not available to use in the next job. "A rule of trade secret management is that the more employee turnover you have, the more difficult it is to maintain the confidentiality of your trade secrets because it is difficult to know most of the time when you have suffered a loss," he says.

Inadvertent disclosure is also a common factor for trade secret loss. Halligan uses an analogy of a cocoon to differentiate what can and cannot be disclosed in the eyes of the law. Inside the cocoon, there is strong protection to the employer regarding the activities of employees. Thus, a trade secret can be openly discussed, left in plain view and copied multiple times as long as it occurs and remains on company grounds. However, once an employee leaves the cocoon, his or her activities are no longer protected. Disclosing trade secrets to a third party without first establishing that (1) the information about to be disclosed is a trade secret, (2) the party agrees to

(<http://nsi.org/Library/Espionage/usta.htm>) and the violators punishable under the federal statute of the Economic Espionage Act of 1996 (www.usdoj.gov/criminal/cybercrime/ipmanual/08ipma.htm). The following are a few examples of how trade secrets are disclosed and stolen:

Inadvertent third-party disclosure
Disgruntled employee
Corporate espionage

Inadvertent third-party disclosure. A company employee is staffing a booth at a trade show when an attendee approaches and begins a casual conversation. The conversation shifts from generalities about the trade show to more specifics about the employee's company. The employee shares information regarding a new product, its features and price point. Unfortunately, the unsuspecting employee is speaking to an undercover agent working for a competitor, whose sole purpose is to case the trade show for inside competitive information. Not only has the employee disclosed trade secrets, but the information no longer retains its trade secret status and thus loses its value.

Disgruntled employee. An employee on a product development team is upset over an apparent lack of recognition for his role in Company A's latest product initiative. He decides to leave the company, but before announcing his departure, he inserts a flash memory card and downloads the R&D files for the entire project. With these trade secrets in hand, he approaches a competitor, Company B, about a potential job opportunity and the willingness to share the information. Prior to Company A

assets. Halligan believes that it's an obligation of every company to establish a trade secret control committee or trade secret officer with the purpose of identifying these assets on a 24-7 basis. "The excuse that it is too overwhelming of a task is simply unacceptable, especially now with software available that identifies, classifies and tracks these assets," he says. (For more information about trade secret identification and its relation to Sarbanes-Oxley compliance, see next month's issue of *Inside Supply Management*®.)

act as a checklist to ensure that you're doing all that you reasonably can under the circumstances." The basics include:

- **Escorting visitors properly through the premises**

- **Providing employee education to foster the awareness and importance of trade secrets**

- **Requiring third parties to sign non-disclosure agreements before exchanging information**

Secret Office, Inc., in Naperville, Illinois, trade secret intellectual property companies every year.



releasing its new product, a similar product from Company B enters the marketplace, thus thwarting any competitive advantage Company A would have derived from its product launch.

Corporate espionage. As a contract is about to expire with an overseas supplier, the company receives an unsuspecting e-mail wishing the company well in its future endeavors. Unfortunately, the good wishes are a smoke screen for a Trojan Horse that was delivered with the e-mail and is now infecting the company's computers and those of its suppliers. Undetected, the company's trade secrets, including information about future projects, are transmitted back to the overseas supplier. The information is then sold to the company's competitor.

Companies are ultimately responsible for educating employees about trade secret assets. Through education and awareness, inadvertent losses are preventable. It starts with policies and initiatives around trade secret protection.

Protecting Trade Secrets

Trade secret protection begins with a process that identifies and classifies these

Supply managers are in a unique position because they are exposed to IP as it is being created. Taro Matsumoto, IP licensing manager for Tokyo Electron in Austin, Texas, says supply managers should get involved in the early product development process not just for cost saving and forecasting purposes, but also for identifying and classifying IP. "When a new concept or idea is being developed, supply managers must recognize the IP implications and closely collaborate with engineering and the supply base to protect trade secret assets," he says. "Understand the key functionalities of the concepts and what type of IP strategy the company will be using for these new products."

Procedurally, Pooley says multinational companies should look to the United States Sentencing Commission Guidelines Manual, online at www.uscc.gov/2004guid/gl2004.pdf, §8b2 (Effective Compliance and Ethics Program), for information about how to implement a trade secret program. "While the federal guidelines represent the gold standard, they should form the basis of a plan for large companies that have a fair amount of risk of trade secret loss," he says. "The guidelines

If a loss of trade secrets occurs and the company intends to go into litigation, the courts will expect that these and other protective measures are in place.

Supply management plays a key role in protecting organizations' IP rights, and these rights should always be in the forefront when engaging suppliers, says Matsumoto. Because supply management is in a distinct position to know each key supplier's characteristics, good or bad, and its relationship with the organization, supply managers should be the primary gatekeeper for trade secrets to external parties. As executives know, the marketplace is extremely competitive. Trade secrets are what give companies their individual identities and separates them from industry competitors. Thus, it is imperative that supply management participate in formulating a process to identify and protect these valuable assets to prevent a colossal loss and maintain the company's foothold in the global market. **ISM**

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